

CITY OF ANN ARBOR EMPLOYEES' RETIREMENT SYSTEM

FINANCIAL REPORT

Fiscal Years Ended June 30, 2004 and 2003



Issued by: Finance Department, 100 N. Fifth Avenue, Ann Arbor, MI 48107 (734) 994-2730

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name City of Ann Arbor Employees Retirement System	County Washtenaw
Audit Date 6/30/04	Opinion Date 10/22/04	Date Accountant Report Submitted to State: December 17, 2004	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

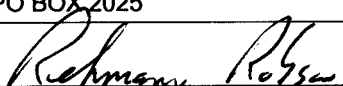
1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	X		
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).			X

Certified Public Accountant (Firm Name) REHMANN ROBSON GERALD J. DESLOOVER, CPA			
Street Address 5800 GRATIOT, PO BOX 2025	City SAGINAW	State MI	Zip 48605
Accountant Signature 			

CITY OF ANN ARBOR
EMPLOYEES' RETIREMENT SYSTEM

FINANCIAL REPORT
Fiscal Years Ended June 30, 2004 and 2003

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REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP



INDEPENDENT AUDITORS' REPORT

October 22, 2004

To the Retirement Board
City of Ann Arbor, Michigan
Employees' Retirement System
Ann Arbor, Michigan

We have audited the accompanying statements of plan net assets of the ***City of Ann Arbor, Michigan Employees' Retirement System*** as of June 30, 2004 and 2003, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Retirement Board. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the City of Ann Arbor, Michigan Employees' Retirement System trust fund and do not purport to, and do not present fairly the financial position of the City of Ann Arbor, Michigan, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the City of Ann Arbor, Michigan Employees' Retirement System as of June 30, 2004 and 2003 and the changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The historical pension information listed in the table of contents is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

Rehmann Robson

CITY OF ANN ARBOR EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
as of June 30, 2004 and 2003

(amounts expressed in thousands)

	2004 Total	2003 Total
Assets		
Cash	\$466	\$403
Receivables:		
Interest and dividends	1,615	1,845
Due from other funds of the City of Ann Arbor	563	25
Total receivables	2,178	1,870
Investments, at fair value:		
Short term investments	8,518	9,502
U. S. government obligations	60,090	60,327
Municipal bonds	657	2,142
Collateralized mortgage obligations	7,729	4,621
Domestic corporate bonds	38,120	90,284
Domestic stocks	236,758	176,906
Real Estate-Direct and funds	26,065	11,291
Total investments	377,937	355,073
Properties at cost, net of accumulated depreciation of \$20 and \$14, respectively	9	14
Total assets	380,590	357,360
Liabilities		
Refunds payable and other	4,424	3,295
Net assets held in trust for pension benefits (A schedule of funding progress is presented on page 6.)	\$376,166	\$354,065

The accompanying notes are an integral part of these financial statements.

CITY OF ANN ARBOR EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF CHANGES IN PLAN ASSETS
for the year ended June 30, 2004 and 2003

(amounts expressed in thousands)

	2004 Total	2003 Total
Additions		
Contributions		
Plan members	\$2,639	\$2,623
Investment income		
Net appreciation in fair value of investments	41,232	346
Interest	6,793	8,549
Dividends	1,168	771
Total investment income	49,193	9,666
Less investment expense	1,590	1,510
Net investment income	47,603	8,156
Total additions	50,242	10,779
Deductions		
Benefits	20,617	19,922
Refunds of contributions	952	1,814
Administrative expense	6,572	6,063
Total deductions	28,141	27,799
Net increase (decrease)	22,101	(17,020)
Net assets held in trust for pension benefits		
Beginning of year	354,065	371,085
End of year	\$376,166	\$354,065

The accompanying notes are an integral part of these financial statements.

CITY OF ANN ARBOR
EMPLOYEES' RETIREMENT SYSTEM

NOTES TO FINANCIAL STATEMENTS
For the Fiscal Years Ended June 30, 2004 and 2003

The City of Ann Arbor Employees' Retirement System (CAAERS) is a single-employer defined benefit plan established and administered by the City of Ann Arbor to provide retirement, disability and death benefits to general, police and firefighter employees and their beneficiaries. Cost of living adjustments are provided to members and beneficiaries per the Ann Arbor City Code Section 1:573 of Chapter 18. Chapter 17.1 of the Ann Arbor City Charter assigns the authority to establish and amend benefit provisions to City Council.

All plan members are required to contribute 5% of annual compensation. The City is required to contribute at an actuarially determined rate; the current rate is 0% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Ann Arbor City Council. Administrative costs of CAAERS are financed through investment earnings.

A. Summary of Significant Accounting Policies

Basis of Accounting. CAAERS' financial statements are prepared using the accrual basis of accounting. Plan member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value Investments. Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value.

B. Plan Description and Contribution Information

Membership of the plan consisted of the following at June 30, 2004, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	757
Terminated plan members entitled to, but not yet receiving, benefits	91
Active plan members	<u>842</u>
Total	<u>1,690</u>
Number of participating employers	1

CITY OF ANN ARBOR
EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS

(amounts expressed in thousands)

<u>Year Ended June 30</u>	<u>Annual Required Contribution</u>	<u>Percentage Contribution</u>
2004	\$ -	100%
2003	-	100%
2002	-	100%
2001	-	100%
2000	1,316	100%
1999	2,653	100%

CITY OF ANN ARBOR
EMPLOYEES' RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS

(amounts expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) AAL [UAAL (OAAL)] (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL (OAAL) as a Percentage of Covered Payroll [(b-a)/c]
6/30/2004	\$409,324	\$370,409	(38,915)	110.5%	\$47,109	-82.6%
6/30/2003	417,623	353,620	(64,003)	118.1%	46,213	-138.5%
6/30/2002	426,440	336,340	(90,100)	126.8%	46,744	-192.8%
6/30/2001	425,538	304,349	(121,189)	139.8%	47,449	-255.4%
6/30/2000	407,468	258,286	(149,182)	157.8%	44,092	-338.3%
6/30/1999	377,462	249,242	(128,220)	151.4%	43,621	-293.9%

CITY OF ANN ARBOR EMPLOYEES' RETIREMENT SYSTEM
NOTE TO THE SCHEDULE OF FUNDING PROGRESS
AND SCHEDULE OF EMPLOYER CONTRIBUTIONS

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows.

Actuarial valuation:

Frequency	Annual
Latest date	June 30, 2004
Basis for contribution	June 30, 2002

Actuarial cost method

Entry age

Amortization method

Level percent – over a period of 15 years

Remaining amortization period

None

Asset valuation method

5-year smoothed market

Actuarial assumptions:

Investment rate of return*	7%
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Projected salary increases	0.4% - 6.3%
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*Includes inflation at:

3.5%

Cost-of living adjustments

Determined annually



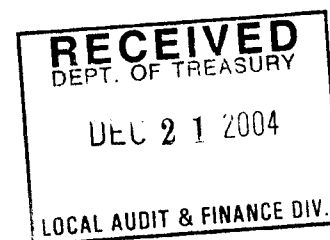
REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

October 22, 2004



To the Retirement Board
City of Ann Arbor, Michigan
Employees' Retirement System
Ann Arbor, Michigan

We have audited the financial statements of the *City of Ann Arbor, Michigan Employees' Retirement System* for the year ended June 30, 2004, and have issued our report thereon dated October 22, 2004. Professional standards require that we provide you with the following information related to your audit.

Our Responsibility Under Generally Accepted Auditing Standards

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with generally accepted accounting principles. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

As part of our audit, we considered the internal control of the City of Ann Arbor, Michigan Employees' Retirement System. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the System are described in Note A to the financial statements.

We noted no transactions entered into by the System during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the System's financial reporting process (that is, cause future financial statements to be materially misstated). We identified a matter related to the proper accounting for certain transactions, and the System has posted the correcting journal entry that we have identified as significant, so that its effect is included in the System's financial statements. In our judgment, this adjustment had a significant effect on the System's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the System's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This information and the attached memorandum are intended for the use of the Retirement Board and management of the System. However, this report is a matter of public record, and its distribution is not limited.

Very truly yours,

Rehmann Johnson

**THE CITY OF ANN ARBOR EMPLOYEES
RETIREMENT SYSTEM
Accounting Memorandum**

For the Year Ended June 30, 2004

During our audit we became aware of a certain issues regarding internal controls over processes. This memorandum summarizes our comments and suggestions regarding these matters. This memorandum does not affect our report dated October 22, 2004, on the financial statements of the Retirement System.

Pensioner Verification Payments Termination Controls (Repeat Comment)

The Pension System presently uses an outside service organization to match social security numbers of retirees/beneficiaries of the City benefit payment file with Pension Benefit Information database files of those that have died and are on the SSA system.

In order to enhance the controls in this area, the Employee Retirement System should consider performing internal (or external) verifications of those receiving benefit payments by confirming the existence of the pensioner or beneficiary receiving the payment, and having the person sign and date the confirmation form to be returned and checked against information in the Pension System files. Once this initial verification process is done, it can be repeated every three, four or five years.

Retiree Health and Life Insurance Costs Transfer

Each year, the Pension System's actuaries prepare a "PA 28 Compliance Test," which determines the maximum amount of retiree health and life insurance costs which may be paid from the retirement system assets. For the year ended June 30, 2004, approximately \$305,000 more was transferred over to the City insurance fund than the compliance test allowed.

In October, proper adjustments were made, and the correct amount of \$6,083,674 was reflected as the amount transferred in the year end audited financial statements. In the future, we recommend that transfers over to the Insurance fund do not exceed the maximum amount allowed based on the compliance test letter and schedule.

* * * * *